



AUDITOR - GENERAL
SOUTH AFRICA

The Accounting officer
Mkhondo Local Municipality
P.O Box 23
Piet Retief
2380

Date: 30 November 2018

Reference: 02394REG17/18

Dear Sir

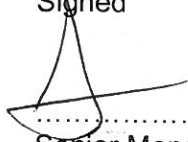
Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Mkhondo Local Municipality for the year ended 30 June 2018

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa [section 121(3) of the Municipal Finance Management Act of South Africa (MFMA)].
2. We have not yet received the other information that will be included in the annual report with the audited financial statements and have thus not been able to establish whether there are any inconsistencies between this information and the audited financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) of the MFMA you are required to include the audit report in the Municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
6. Please notify the undersigned Business Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely

Signed

A handwritten signature in black ink, consisting of a stylized 'T' and 'M' combined, with a horizontal line extending to the right.

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Senior Manager: Mpumalanga Business unit

Enquiries: Tshepo Maifo
Telephone: (013) 756 0800
Fax: (013) 756 0879

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Mkhondo Local Municipality

Report on the audit of the financial statements

Qualified opinion

1. I have audited the financial statements of the Mkhondo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2018, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the effects of the matters described in the basis for qualified opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Mkhondo Local Municipality as at 30 June 2018, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2017 (Act No. 3 of 2017) (Dora).

Basis for qualified opinion

Property, plant and equipment

3. In terms of GRAP 17, *Property, plant and equipment*, the municipality should maintain proper systems to record and account for all assets. Contrary to this, unreconciled differences were noted between the fixed asset register and the financial statements, resulting in an overstatement of R55 182 931. In addition, I was unable to obtain sufficient appropriate audit evidence to support the adjustments made to the reconstructed fixed asset register. I could not confirm these adjustments by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to property, plant and equipment stated at R1 547 016 943 (2016-17: R1 601 489 441) and depreciation stated at R202 432 454 (2016-17: R201 943 263) in notes 11 and 32 to the financial statements, respectively.

Biological assets

4. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for biological assets, due to the non-submission of information to support the valuation performed to fair-value the plantations owned by the municipality. I was unable to confirm these valuations by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to biological assets and fair value adjustments stated at R30 052 80 (2016-17: R59 684 288) and R29 631 479 (2016-17: R12 580 521) in notes 9 and 38 to the financial statements, respectively.

Investment property

5. I was unable to obtain sufficient appropriate audit evidence for investment property, as the municipality changed the accounting policy from the cost model to the fair value model and was unable to provide supporting documentation for the fair value adjustments. I could not confirm the amounts by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to investment property and fair value adjustments stated at R76 575 000 (2016-17: R76 575 000) and R0 (2016-17: R44 104 200) in notes 10 and 38 to the financial statements, respectively.

Payables from exchange transactions

6. The municipality did not recognise all the obligations for payables from exchange transactions in accordance with GRAP 1, *Presentation of financial statements*, as differences were noted between the general ledger and the financial statements amounting to R9 880 278. Differences were also noted between the amounts recorded in the payables listing and the amounts per the suppliers statements amounting to R37 829 724. Consequently, payables from exchange transactions and operating expenditure were understated by R27 949 446. Additionally, there was an impact on the surplus for the period.

Context for the opinion

7. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of this auditor's report.
8. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* (IESBA code) and the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
9. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

10. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

11. As disclosed in notes 51 and 52 to the financial statements, the corresponding figures for 30 June 2017 were restated as a result of an error in the financial statements of the municipality at, and for the year ended, 30 June 2018.

Material losses – electricity

12. As disclosed in note 50 to the financial statements, material electricity losses of R42 404 706 (2016-17: R22 591 918) were incurred, which represented 37% (2016-17: 20%) of the total electricity purchased.

Material losses – water

13. As disclosed in note 50 to the financial statements, material water losses of R1 271 460 (2016-17: R129 203) were incurred, which represented 31% (2016-17: 6%) of the total water purchased.

Material impairments

14. As disclosed in note 7 to the financial statements, the receivables balance was significantly impaired. The impairment of consumer debtors amounted to R292 717 020 (2016-17: R228 442 973). The contribution to the provision for debt impairment was R64 274 047 (2016-17: R60 038 252).

Unauthorised, irregular, and fruitless and wasteful expenditure

15. As disclosed in note 47 to the financial statements, the municipality incurred unauthorised expenditure of R230 763 181, due to the overspending of the approved operational budget.
16. As disclosed in note 48 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R13 420 539, due to interest charges on overdue accounts.
17. As disclosed in note 49 to the financial statements, the municipality incurred irregular expenditure of R30 712 824, as it did not follow proper procurement and contract management processes.

Other matter

18. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

19. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

20. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

21. In preparing the financial statements, the accounting officer is responsible for assessing the municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

22. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
23. A further description of my responsibilities for the audit of the financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

24. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
25. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
26. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected objective presented in the annual performance report of the municipality for the year ended 30 June 2018:

Objective	Pages in the annual performance report
Objective 5 – provision of basic services	xx – xx

27. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
28. The material findings in respect of the usefulness and reliability of the selected objective are as follows:

Objective 5 – provision of basic services

29. The strategic objective approved in the annual performance plan and the objective in the annual performance report was not consistent, as indicated below:

Reported strategic objective per service delivery and budget implementation plan	Reported objective per annual performance report
To ensure provision of basic services (Water, Electricity, Sanitation and Waste removal)	To ensure provision of basic services (Electricity, Water and sanitation, Roads and storm water, Infrastructure Development (PMU), Water Removal, By-Law development & enforcement)

Indicators not well defined and could not be measured for usefulness

30. The following indicators could not be measured and verified, as they were measured as percentages and the technical indicator descriptions did not define the data collection for the numerator and the denominator. This was due to a lack of technical indicator descriptions, proper performance management systems and processes, and formal standard operating procedures or documented system descriptions that predetermined how the achievement would be measured, monitored and reported.

Indicator description	Reported achievement
% of reported electric faults attended to	100%
% of electricity losses reduced to	27.5%
% of new waste and waste water connection provided	100%
% of graves supplied over graves applied for	100%
Number of parks and recreational facilities maintained	50
% of illegal dumping sports identified cleared	100%

Various indicators with limitation misstatements

31. I was unable to obtain sufficient appropriate audit evidence to support the reported achievement of the target. This was due to lack of a technical indicator descriptions, proper performance management systems and processes, and formal standard operating procedures or documented system descriptions that predetermined how the achievement would be measured, monitored and reported. I was unable to confirm the reported achievement of the indicator by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement as reported in the annual performance report.

Indicator description	Reported achievement
% of reported electric faults attended to	100%
% of electricity losses reduced to	27.5%
% of new waste and waste water connection provided	100%
% of graves supplied over graves applied for	100%
Number of parks and recreational facilities maintained	50
% of illegal dumping sports identified cleared	100%

Various indicators with limitation misstatements

32. I was unable to obtain sufficient appropriate audit evidence for the achievement and the related measures taken to improve performance as reported in the annual performance report for the indicators listed below. Limitations were placed on the scope of my work, as the actual level of achievement could not be supported. I was unable to confirm the reported achievement and the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements and the reported measures taken to improve performance.

Indicator description	Planned target	Reported achievement
Megaliters of water provided to communities	5800	8481.95
Megaliters of waste water and septic tanks drained	2555	2620.68
Number of dignified sanitation constructed	200	200
KMs of bulk pipe line installed	10km	10km
Number of pump stations constructed	1	1
Number of refuse collections trips to serviced areas	816	1105
Number of streets cleaned in the CBD	15	15

Indicator description	Planned target	Reported achievement
Number of mass refuse container trips made	208	208
Number of stakeholders awareness and clean-up campaigns held	4	9
Number of green projects established	2	2
KMs of electrical network maintained	118	42

Various indicators with disagreement and limitation misstatements

33. The municipality did not have an adequate record-keeping system to enable reliable reporting on the achievement of the indicators listed below. As a result, I was unable to obtain sufficient appropriate audit evidence in some instances; while in other cases, the supporting evidence provided did not agree to the reported achievements. Based on the supporting evidence that was provided, the achievement of these indicators was different to the reported achievement in the annual performance report. I was also unable to further confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievements of the indicators listed below.

Indicator description	Reported achievement	Audited value
Number of electricity meters installed	340	71
Number of street lights maintained	699	821
Square meters (M2) of tar road potholes repaired	10 845M2	9513
KMs of storm water pipes maintained	9.37km	30

Various indicators with disagreement misstatements

34. Based on the supporting evidence that was provided, the achievement of this indicator was different to the reported achievement in the annual performance report.

Planned target	Reported achievement	Audited value
KMs of roads maintained and graded	50km	190

Other matters

35. I draw attention to the matters below.

Achievement of planned targets

36. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraphs 29 to 34 of this report.

Adjustment of material misstatements

37. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of objective 5 – provision of basic services. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

38. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
39. The material findings on compliance with specific matters in key legislation are as follows:

Annual financial statements

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of revenue and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
42. Reasonable steps were not taken to prevent irregular expenditure amounting to R30 712 824, as disclosed in note 49 to the financial statements, as required by section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by non-compliance with the procurement processes as prescribed in the Supply Chain Management (SCM) Regulations.

43. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R13 420 539, as disclosed in note 48 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was caused by interest on overdue accounts and South African Revenue Services penalties.
44. Reasonable steps were not taken to prevent unauthorised expenditure amounting to R230 673 181, as disclosed in note 47 to the financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the unauthorised expenditure was caused by expenditure exceeding the budgeted amount due to poor controls over the monitoring of the budget spending.
45. Expenditure was incurred in excess of the approved budget, in contravention of section 87(8) of the MFMA.

Asset management

46. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
47. Capital assets were disposed of without considering the fair market value of the assets and the economic value to be received in exchange for the assets, as required by section 14(2)(a) and 14(2)(b) of the MFMA.

Liability management

48. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Procurement and contract management

49. Some quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
50. Some goods and services with a transaction value below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c).
51. Some quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
52. Some contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
53. Some contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).

54. The performance of some contractors was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.

Consequence management

55. The authorisation of unauthorised expenditure amounting to R454 837 409 was not done through an adjustment budget, as required by section 32(2)(a)(i) of the MFMA.

Other information

56. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report, which includes the audit committee's report. The other information does not include the financial statements, the auditor's report thereon and the selected objective presented in the annual performance report that has been specifically reported on in the auditor's report.
57. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
58. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected objective presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
59. I have read the other information included in the draft annual report.
60. I have nothing to report in this regard.

Internal control deficiencies

61. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
62. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
63. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
64. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.

65. Management did not review and monitor compliance with applicable laws and regulations.
66. The audit committee and internal audit unit did not influence the audit opinion, as their recommendations were not implemented effectively.

Auditor-General

Mbombela

30 November 2018



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general’s responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for the selected objective and on the municipality’s compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in this auditor’s report, I also:
 - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality’s internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer’s use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the municipality’s ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor’s report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of this auditor’s report. However, future events or conditions may cause a municipality to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.